CENTER FOR INDIVIDUAL FREEDOM

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"SIMPLIFICATION" IS NOT THE EASY ANSWER

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For more than a decade, the Internet has been a driving force in our prospering economy, despite temporary setbacks. Our country's relative economic strength in technology areas is due, in part, to the political establishment's recognition that the Internet and e-commerce should be free from legislative and regulatory roadblocks that could impede its evolution.

Congress, in recognizing the Internet's susceptibility to creative tax schemes and the need to protect this engine of prosperity, adopted the Internet Tax Freedom Act (ITFA) in October of 1998. It imposed a three-year moratorium on multiple and discriminatory taxes on e-commerce and taxes on Internet access. In 2001, Congress extended the moratorium for two years.

With the moratorium now set to expire in November, the debate over its extension is once again being clouded by a coalition of states crying poor, as more consumers shop online. Many of these revenue-hungry states are obstructing any extension of ITFA unless Congress agrees to tie it to the more controversial issue of sales and use tax collection, euphemistically known as "simplification."

In 1992, the U.S. Supreme Court ruled in *Quill Corp. v. North Dakota* that states, without permission from Congress, cannot require out-of-state retailers to collect and remit sales and use taxes unless the retailer has a substantial physical presence or "nexus" in the state.

Many of our nation's governors, together with traditional brick-and-mortar retailers who oppose online competition, are lobbying Congress to accept the states' "simplification" plan known as the Streamlined Sales Tax Project. In exchange, the states want permission to reach outside of their taxing jurisdictions, shifting the states' tax collection burden to remote vendors. But the "simplifications" are anything but simple.

First, the proposed "simplification" scheme contradicts the economic structure that has made our nation a global leader. Contrary to the view of one of our Founding Fathers, Alexander Hamilton, who noted in the Federalist No. 32 that the Constitution did not grant Congress the authority to regulate state tax policies except with regard to exports and imports, it has long been recognized that Congress has the authority, under the Commerce Clause, to regulate state taxation of interstate activities. But the primary evil that the Commerce Clause sought to remedy was attempts by states to export their tax burdens to residents of other states. Because local residents and brick-and-mortar entities benefit from state and local services and infrastructure such as police and fire protection, roads and waste collection, it is appropriate for them, and only them, to bear the tax burdens that finance such services. Based on this premise, out-of state entities should not be forced to take on the states' responsibility and collect their taxes for them.

Second, the financial burden on remote businesses to collect and remit states' sales and use taxes would ultimately result in a de facto tax increase on the consumer. As with any government mandate, especially when dealing with tax schemes, the added costs of doing business are ultimately passed on to consumers by way of increased prices.

There currently are more than 7,500 taxing jurisdictions in this country – all with different, complicated rules and structures. The proposed "simplification" does not go far enough in significantly reducing or simplifying these rules and structures to the point where businesses would not have to endure a considerable financial hardship.

Third, ironically the states' proposed method of "simplification" could reasonably be considered a violation of state sovereignty. Our country's historical framework of "no taxation without representation" led to a system of taxation that has traditionally required state legislatures to develop tax policies within their own borders. As a result, states' tax and regulatory policies employ fiscal incentives such as tax abatements and subsidies in attempting to induce non-resident firms and businesses to locate within their jurisdictions or to keep resident businesses from moving elsewhere. Congressionally approved collusion between rival states would ultimately eliminate such competition, thereby threatening our system of state sovereignty. Such lack of fiscal competition between the states would undoubtedly have a negative impact on consumers and the economy.

Finally, the implication "simplification" would have on consumer privacy is an open question. Apart from any records that an Internet vendor may keep and use in accordance with the privacy policy that it has adopted, electronic commerce permits an Internet purchaser to maintain a level of anonymity from "big-brother" watching his or her purchasing practices. With few exceptions, the government cannot obtain vendor records without following appropriate search warrant procedures designed to protect the purchaser's fundamental right to privacy. With simplification, however, the audit procedures proffered threaten consumer privacy. The access to personal data that may result through audit procedures leaves consumers vulnerable to misuses of sensitive information and potentially violates consumers' constitutional rights of privacy and due process. Although some proposals in past Congresses make passing reference to the need for appropriate protections for consumer privacy, no simplification proposal significantly addresses the issue. Simplification should not be included in any bill unless and until all potential threats to privacy and constitutional rights have been addressed. It is doubtful that can ever be done.

One final and significant point is that Congress simply should reaffirm the Supreme Court Quill ruling governing states' collection of sales taxes by adopting a national, uniform nexus standard, as outlined in the New Economy Tax Fairness Act or NET FAIR (S. 664), sponsored by Senator Judd Gregg (R-New Hampshire) in the 107th Congress. NET FAIR would have established a bright-line uniform jurisdictional standard for taxing electronic commerce based on the substantial physical presence or "nexus" test that would secure traditional principles of tax fairness, reinforce rate competition among the states and preserve the states' authority to set their own tax policies on commerce within their jurisdictions.

Congress can, and must, pass legislation that makes permanent the current moratorium on multiple and discriminatory e-commerce taxes and Internet access taxes while dealing with the simplification issue separately. As language often defines political battles, and in some cases wins them, the term "simplification" is anything but "simple."

The Center for Individual Freedom (www.cfif.org) is a non-partisan organization that fights to protect individual freedoms and rights in the legal, legislative and educational arenas. As free-market advocates, we oppose over-burdensome state and federal regulations and taxing regimes that will impede the evolution of electronic commerce. **Contact: Jeffrey Mazzella, Sr. Vice President, Legislative Affairs • *jmazzella@cfif.org***